

INDEX

	Page
Opinion Below	1
Jurisdiction	1
Question presented	2
Convention, statutes and regulations involved	2
Statement	2
Summary of argument	4
Argument:	
Article XIV of the Income Tax Convention with the United Kingdom does not exempt nondistributable capital gains realized and retained by an American trust whose bene- ficiaries are citizens and residents of the United Kingdom	5
A. The text of the Convention forecloses the claim of exemption	7
B. The history of the treaty suggests a narrow reading of Article XIV	15
C. The Treasury Regulations promul- gated under the Convention reject petitioner's claim of exemption	23
Conclusion	27
Appendix	28

CITATIONS

Cases:

<i>Alabama v. King & Boozer</i> , 314 U.S. 1	11
<i>American Trust Co. v. Smyth</i> , 247 F. 2d 149	4
<i>Anderson v. Wilson</i> , 289 U.S. 20	13
<i>Biddle v. Commissioner</i> , 302 U.S. 573	11
<i>Chew Heong v. United States</i> , 112 U.S. 536	14
<i>Choctaw Nation v. United States</i> , 318 U.S. 423	15

Cases—Continued

	Page
<i>Cook v. United States</i> , 288 U.S. 102	15
<i>Curry v. United States</i> , 314 U.S. 14	11
<i>Factor v. Laubenheimer</i> , 290 U.S. 276	15, 25
<i>Graves v. N.Y. ex rel. O'Keefe</i> , 306 U.S. 466	11
<i>Helvering v. Gerhardt</i> , 304 U.S. 405	11
<i>Helvering v. Hutchings</i> , 312 U.S. 393	24
<i>Home Savings Bank v. Des Moines</i> , 205 U.S. 503	12
<i>Kern-Limerick, Inc. v. Scurlock</i> , 347 U.S. 110	11
<i>Klein v. Board of Supervisors</i> , 282 U.S. 19	11
<i>Kolovrat v. Oregon</i> , 366 U.S. 187	25
<i>Nielsen v. Johnson</i> , 279 U.S. 47	15, 25
<i>Oklahoma Tax Comm'n v. Texas Co.</i> , 336 U.S. 342	11
<i>Pigeon River Co. v. Cox Co.</i> , 291 U.S. 138	25
<i>Rocca v. Thompson</i> , 223 U.S. 317	15
<i>United States v. Lee Yen Tai</i> , 185 U.S. 213	14
<i>United States v. Stewart</i> , 311 U.S. 60	14
<i>Whitney v. Robertson</i> , 124 U.S. 190	14

Treaties and Statutes:

<i>Agreement between the United States and the United Kingdom</i> , 9 U.S. Treaties 1459, 2 Leg. Hist. 2951	27
<i>Income Tax Convention between United States and Canada</i> , 56 Stat. 1399:	
Art. VIII, 1 Leg. Hist. 473, 478	21
Art. XVII, 1 Leg. Hist. 481	21
<i>Income Tax Convention between United States and Denmark</i> , 62 Stat. 1730, Art. XII, 1 Leg. Hist. 711, 717	19
<i>Income Tax Convention between United States and France</i> , 59 Stat. 893:	
Art. 11, 1 Leg. Hist. 905, 914	21
Art. 14A, 1 Leg. Hist. 915-916	21
<i>Income Tax Convention between United States and the Netherlands</i> , 62 Stat. 1757, Art. XI, 2 Leg. Hist. 1921, 1927	19

Treaties and Statutes—Continued

Income Tax Convention between United States and Sweden, 54 Stat. 1759:

Art. IX, 2 Leg. Hist. 2355, 2362	Page 21
Art. XIV(a), 2 Leg. Hist. 2365	21

Income Tax Convention between the United States and the United Kingdom, 60 Stat. 1377, 2 Leg. Hist. 2769:

Art. II(1)	7, 9, 17, 21
Art. II(2)	17
Art. II(3)	9, 10
Art. XIV	3, 4, 5, 6, 7, 8, 10, 12, 14, 15, 16, 17, 18, 20, 22, 23, 24, 25

Internal Revenue Code of 1939:

Sec. 22(b) (26 U.S.C. 1952 ed., Sec. 22(b))	6, 14
Sec. 62 (26 U.S.C. 1952 ed., Sec. 62)	26
Sec. 101 (26 U.S.C. 1952 ed., Sec. 101)	14
Sec. 115(b) (26 U.S.C. 1952 ed., Sec. 115(b))	14
Sec. 161 (26 U.S.C. 1952 ed., Sec. 161)	8
Sec. 161(a) (26 U.S.C. 1952 ed., Sec. 161(a))	13
Secs. 161-164 (26 U.S.C. 1952 ed., Secs. 161-164)	12
Sec. 162(a) (26 U.S.C. 1952 ed., Sec. 162(a))	12
Sec. 162(b) (26 U.S.C. 1952 ed., Sec. 162(b))	13
Sec. 165 (26 U.S.C. 1952 ed., Sec. 165)	14
Sec. 211 (26 U.S.C. 1952 ed., Sec. 211)	16
Sec. 212(b) (26 U.S.C. 1952 ed., Sec. 212(b))	14
Sec. 3797(a) (26 U.S.C. 1952 ed., Sec. 3797(a))	10

Internal Revenue Code of 1954:

Sec. 501(a) (26 U.S.C. 1958 ed., Sec. 501(a))	14
---	----

Treaties and Statutes—Continued

Internal Revenue Code of 1954—Continued

Sec. 521(a) (26 U.S.C. 1958 ed., Sec. 521(a))	Page 14
Sec. 641 (26 U.S.C. 1958 ed., Sec. 641)	2, 8
Secs. 641-668 (26 U.S.C. 1958 ed., Secs. 641-668)	12
Sec. 642 (26 U.S.C. 1958 ed., Sec. 642)	2
Sec. 642(c) (26 U.S.C. 1958 ed., Sec. 642(c))	12
Sec. 643 (26 U.S.C. 1958 ed., Sec. 643)	2
Sec. 643(a) (26 U.S.C. 1958 ed., Sec. 643(a))	13
Sec. 651 (26 U.S.C. 1958 ed., Sec. 651)	2
Sec. 652 (26 U.S.C. 1958 ed., Sec. 652)	2
Sec. 661 (26 U.S.C. 1958 ed., Sec. 661)	2
Sec. 662 (26 U.S.C. 1958 ed., Sec. 662)	2
Secs. 671-677 (26 U.S.C. 1958 ed., Sec. 671-677)	6
Sec. 894 (26 U.S.C. 1958 ed., Sec. 894)	6, 14
Sec. 7701(a) (26 U.S.C. 1958 ed., Sec. 7701(a))	8, 10
Sec. 7852(d) (26 U.S.C. 1958 ed., Sec. 7852(d))	6
Revenue Act of 1936, c. 690, 49 Stat. 1648, Sec. 211	16
Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 160	17
Revenue Act of 1950, 64 Stat. 906, 3213	17
Revenue Act of 1962, P.L. 87-834, 76 Stat. 960, Sec. 7	12
Second Supplementary Protocol of May 25, 1954, to the Income Tax Convention with the United Kingdom, 6 U.S. Treaties 37, 2 Leg. Hist. 2819	27
Finance Act, 1962, c. II, Secs. 10-16, 10 and 11 Eliz. 2, c. 44, Law Reports, Statutes, 1962, Part 3, pp. 695, 707	23

Treaties and Statutes—Continued

Connecticut General Statutes Annotated, § 45-112.....	Page 3
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Miscellaneous:

American Law Institute, <i>Restatement of the Foreign Relations Law of the United States</i> (Proposed Official Draft, 1962), c. 4, p. 536, Sec. 155, p. 558 <i>et seq.</i>	15, 25
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British Double Taxation Relief (Taxes on Income) (General) Regulations, 1946, Vol. X Statutory Rules and Orders and Statutory Instruments, Revised to December 31, 1948, pp. 328-331.....	24
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91 Cong. Record, p. 7448, 2 Leg. Hist. 2669.....	18
92 Cong. Record, pp. 946-947, 2 Leg. Hist. 2673.....	18
94 Cong. Record: P. 8622, 1 Leg. Hist. 703-704.....	19
P. 8625, 2 Leg. Hist. 1914.....	19
Dalton, <i>Principles of Public Finance</i> , pp. 23-24, 36.....	12
Ehrenzweig and Koch, <i>Income Tax Treaties</i> , pp. 288-296.....	24
1958 Final Report of the Royal Commission on the Taxation of Profits and Income, Cmd. 9474, pp. 25, <i>et seq.</i> , 365, <i>et seq.</i> , 425, <i>et seq.</i>	22
G.C.M. 10423, XI-2 Cum. Bull. 123 (1932).....	14

Miscellaneous—Continued

Harvard Research in International Law: Law of Treaties, Supplement to 29 Amer. Journal of Int. Law, p. 937	Page 15
Harvard Law School, World Tax Series, <i>Taxation in the United Kingdom</i> , par. 5/3.4	10
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2 Hearing on Conventions With Great Britain and Northern Ireland, Respecting Income and Estate Taxes, S. Execs. D and E, 79th Cong., 2d Sess., (Part 2), pp. 116-120, 2 Leg. Hist. 2712-2716	18
Hearings on Convention With France on Double Taxation, S. Exec. A, 80th Cong., 1st Sess., p. 24, 1 Leg. Hist. 962	26
H. Rep. No. 1546, 75th Cong., 1st Sess., pp. 30-31 (1937) (1939-1 Cum. Bull. (Part 2) 704, 725-726)	17
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Miscellaneous—Continued

	Page
Lidstone, <i>Liberal Construction of Tax Treaties</i> , 47 Cornell L.Q. 529, 544-546.....	15
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O.D. 743, 3 Cum. Bull. 203 (1920).....	14
Rev. Rul. 56-30, 1956-1 Cum. Bull. 646.....	12
Rev. Rul. 59-56, 1959-1 Cum. Bull. 737.....	22
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S. Exec. D, 79th Cong., 1st Sess., pp. 1, 2, 4, 5, 2 Leg. Hist. 2573, 2574, 2576, 2577.....	20, 22
S. Exec. F, 81st Cong., 2d Sess., pp. 1, 3, 5, 2 Leg. Hist. 1584-A, 1584-C, 1584-E.....	19, 20
S. Exec. Rep. No. 1, 82d Cong., 1st Sess., pp. 19-20, 1 Leg. Hist. 603-604.....	19
S. Exec. Rep. No. 4, 78th Cong., 2d Sess., p. 1, 1 Leg. Hist. 881.....	21
S. Exec. Rep. No. 4, 79th Cong., 2d Sess., pp. 1, 2, 3-8, 11-19, 2 Leg. Hist. 2721, 2722, 2723-2728, 2731, 2738-2739.....	18, 22
S. Exec. Rep. No. 6, 79th Cong., 1st Sess., pp. 1, 2, 3-4, 5, 6, 12, 2 Leg. Hist. 2651, 2652, 2653-2654, 2655, 2656, 2662.....	17, 20, 21, 22
S. Exec. Rep. No. 10, 80th Cong., 2d Sess., p. 2, 1 Leg. Hist. 698.....	19
S. Exec. Rep. No. 11, 80th Cong., 2d Sess., p. 2, 2 Leg. Hist. 1908.....	19
S. Rep. No. 1242, 75th Cong., 1st Sess., pp. 32-33 (1937) (1939-1 Cum. Bull. (Part 2) 703, 725-726).....	17
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VIII

Miscellaneous—Continued

Staff of the Joint Committee on Internal Revenue Taxation, U.S. Congress, A Topical Comparison of United States Income Tax Conventions.....	Page 15, 21
T.D. 5532, 1946-2 Cum. Bull. 73.....	24
T.D. 5569, 1947-2 Cum. Bull. 100.....	24
Treasury Regulations on Tax Convention with United Kingdom (26 C.F.R., Part 507):	
Sec. 507.2.....	12
Sec. 507.3.....	12
Sec. 507.4.....	12
Sec. 507.5.....	12
Sec. 507.8.....	12
Sec. 507.10.....	2, 12, 25, 28
Sec. 507.102.....	26
Sec. 507.103.....	2, 12, 24, 28
Sec. 507.104.....	12, 24
Sec. 507.108.....	2, 12, 24, 29
Sec. 507.112.....	2, 24, 30
Treasury Regulations on Tax Convention with Canada (26 C.F.R. 519.11).....	21
Treasury Regulations on Tax Convention with France (26 C.F.R. 514.7).....	21
Treasury Regulations on Tax Convention with Sweden (26 C.F.R. 502.102).....	21

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 240

ANDRE MAXIMOV, ETC., PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the district court (R. 17-18) is not reported. The opinion of the court of appeals (R. 20-30) is reported at 299 F. 2d 565.

JURISDICTION

The judgment of the court of appeals (R. 30) was entered on February 14, 1962. On May 8, 1962, by order of Mr. Justice Harlan, the time for filing a petition for certiorari was extended to and including July 14, 1962 (R. 31). The petition was filed on July 10, 1962, and was granted on October 8, 1962 (R. 32). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether nondistributable capital gains realized and retained by an American trust whose beneficiaries are citizens and residents of the United Kingdom are exempted from United States income tax by Article XIV of the Income Tax Convention between the United States and the United Kingdom, which exempts capital gains of a "resident of the United Kingdom."

CONVENTION, STATUTES AND REGULATIONS INVOLVED

The Income Tax Convention between the United States and the United Kingdom, 60 Stat. 1377, is set forth in the separately-bound Appendix to Petitioner's Brief (Pet. App. A1-A21). Portions of Sections 641, 642, 643, 651, 652, 661 and 662 of the Internal Revenue Code of 1954, pertaining to the taxation of domestic trusts, are set forth at Pet. App. A23-A27. Sections 507.10, 507.103, 507.108, 507.112 of the Treasury Regulations under the Convention with the United Kingdom are set forth in the Appendix, *infra*, pp. 28-31.

STATEMENT

The petitioner is a private trust, established in Connecticut under a deed of trust dated October 24, 1947, by H. Robbin Fedden (R. 10-15). The grantor, who is also life-income beneficiary, was at all relevant times a citizen and resident of the United Kingdom, as were his wife, Renee, who is contingent successor life-income beneficiary,¹ and his children, Katharine

¹ The contingencies as to the wife were (1) that she survive the grantor (R. 11); (2) that she be married to the grantor at his death (R. 11); (3) that the trust should not have been

and Frances, who are contingent remaindermen² (R. 16-17).

Andre Maximov is the successor trustee (R. 14, 15-16). He is a citizen and resident of the United States (R. 2, 4, 6). During 1954 and 1955 the trust sold securities and realized capital gains which were retained and added to corpus (R. 5, 7), as required by controlling Connecticut law.³ The trustee reported these gains as part of the trust's income and paid the federal income tax thereon in the amounts of \$53.10 for 1954 and \$1,316.32 for 1955 (R. 2-3, 4-5, 6-8, 8-9). Thereafter the trustee filed claims for refund of the capital gains tax so paid, alleging exemption under Article XIV of the Income Tax Convention between the United States and the United Kingdom (R. 4-8). When they were disallowed (R. 3, 8), he filed suit on October 28, 1959, in the United States District Court for the Southern District of New York (R. 1-3).

On cross motions for summary judgment, the district court, following the decision of the Court of Appeals for the Ninth Circuit in *American Trust*

terminated by the grantor prior to his death (R. 15); and (4) that the trust should not have been exhausted through exercise by the trustee of his discretionary power to pay over principal (R. 11).

² The contingencies as to the children were (1) that they survive their parents (or at least their father, if their parents are not married at the father's death) (R. 11); (2) as to a portion of their respective interests, that the grantor should have no later born children; (3) and (4), the same contingencies as for the grantor's wife (see note 1, *supra*).

³ See Conn. Gen. Stat. Ann., § 45-112. The trust instrument expressly provides that Connecticut law shall govern (R. 14).

Company v. Smyth, 247 F. 2d 149, denied the government's motion and granted the plaintiff's motion (R. 17-18). Judgment for the plaintiff in the full amounts claimed was subsequently entered (R. 19). On appeal by the United States, the Court of Appeals for the Second Circuit reversed (R. 21-30).

SUMMARY OF ARGUMENT

A. Article XIV of the Income Tax Convention between the United States and the United Kingdom exempts, from the United States tax on capital gains, only British residents. The petitioner trust, as an American resident for tax purposes, does not qualify. And, while the English beneficiaries satisfy the residence requirement, as to the capital gains retained by the trust they are not the taxpayer.

The suggestion that the trust should be ignored and the beneficiaries viewed as the direct recipients of the income finds no support in the language of the Convention. It is at war with the American tax system which rejects economic burden concepts and treats the trust as a distinct juridical personality, separately taxable on its own retained income. The Convention does not purport to override our revenue laws in this respect. On the contrary, there is explicit deference to the local law of the taxing government in the interpretation of undefined terms. In any event, the rule favoring accommodation between treaties and domestic law requires rejection of the present claim. Whatever doubts exist must be resolved against the taxpayer who asserts, at best, an implied exemption.

B. The history of the Convention confirms our reading of Article XIV. The Article was accepted here only reluctantly, in a climate of growing hostility toward exemptions for nonresident aliens. Ratification was based on the precedent of earlier tax treaties which had been interpreted as denying exemption to capital gains retained by an American trust with foreign beneficiaries and on explicit assurances that the British treaty would confer no wider exemptions.

There is nothing to suggest that the Convention was meant to affect domestic taxation of local residents. On the contrary, every indication is that the two governments were concerned only with international problems of double taxation and fiscal evasion, matters wholly foreign to this dispute.

C. The American regulations promulgated under the Convention reject petitioner's claim. It seems clear they were approved by the British government before issuance. In any event, having been in effect for more than sixteen years with the acquiescence of both governments, the presumption is that the regulations correctly interpret the Convention.

ARGUMENT

ARTICLE XIV OF THE INCOME TAX CONVENTION WITH THE UNITED KINGDOM DOES NOT EXEMPT NONDISTRIBUTABLE CAPITAL GAINS REALIZED AND RETAINED BY AN AMERICAN TRUST WHOSE BENEFICIARIES ARE CITIZENS AND RESIDENTS OF THE UNITED KINGDOM

It is conceded that, absent Article XIV of the Income Tax Convention with the United Kingdom

(Pet. App. A-1, A-13), the petitioner trust itself,⁴ having retained the gains, would owe the contested tax notwithstanding that the beneficiaries are all nonresident aliens. But the treaty, it is said, works an exemption and relieves the trust of this obligation.⁵

The provision invoked stipulates:

A resident of the United Kingdom not engaged in trade or business in the United States shall be exempt from United States tax on gains from the sale or exchange of capital assets.

On its face, Article XIV obviously does not exempt the present trust, at least directly. For the American trust is plainly not a "resident of the United Kingdom." The contention is, however, that the British beneficiaries, albeit they themselves owe no tax on the transactions in question, are exempted, and that, through them, the American trust is excused from its tax liability. The argument is that "exempt" in this context does not mean exonerated from *paying* the tax, but, rather, relieved of the *ultimate economic burden* of the tax.

⁴ Petitioner has never claimed that the capital gains were taxable to the grantor, rather than the trust, under the special provisions of Sections 671-677 of the 1954 Code, 26 U.S.C. 671-677. Quite properly, he now agrees that the argument is foreclosed (Br. 4, n. 1).

⁵ Of course, if the capital gains involved are exempt under the treaty, they are exempt under our law. Sec. 22(b)(7), 1939 Code; Secs. 894, 7852(d), 1954 Code. Whether the treaty overrules domestic law in this respect is, however, the very issue in this case. Cf. Pet. Br. 37.

Petitioner's reading of Article XIV is, at best, a strained construction of the text. Nothing requires it. On the contrary, we will show that the language, the history, and the contemporaneous interpretation of the Convention compel a rejection of the argument.

A. THE TEXT OF THE CONVENTION FORECLOSES THE CLAIM OF EXEMPTION.

At the outset, it is apparent that Article XIV of the United Kingdom Convention exempts *persons*, not income as such. It is the "resident of the United Kingdom" who is exonerated "from the United States tax;" the capital gains themselves are not granted immunity from taxation because of their character, or their source. Accordingly, the provision is inapplicable unless some person qualifies to claim the exemption.

Certainly, the taxpayer-trust itself is not a "resident of the United Kingdom" by virtue of its British beneficiaries. The Convention itself makes this clear in Article II(1)(g) (Pet. App. A3) which defines a British resident as a "person * * * who is resident in the United Kingdom for the purposes of United Kingdom tax" and, at the same time, is "not resident in the United States for the purposes of United States tax." The present trust fails to qualify on both grounds. There is no suggestion that the British government views the petitioner trust as a British resident for tax purposes. Nor does our law consider a trust created and administered in the United States a nonresident for tax purposes merely because its beneficiaries are residing abroad. On the contrary, under our tax laws a trust is a separate taxable entity, apart from its

beneficiaries. Secs. 161, 3797(a)(1), 1939 Code; Secs. 641, 7701(a)(1), 1954 Code. And, whatever the test for determining the residence of a trust, the question is resolved without noticing the domicile of the beneficiaries. See Rev. Rul. 62-154, I.R.B. 1962-38, p. 8. Plainly, the petitioner trust, established in the United States, governed by American law, and locally administered by an American trustee, is deemed a domestic trust for tax purposes.

The beneficiaries, then, must claim the exemption in their own right. As British citizens and residents, they qualify. But they are not the recipients of the gains at the time the exemption is claimed. Nor are they liable for the related tax. Yet, Article XIV, on its face, seems to deal with the British resident only with respect to *his own* income and *his own* tax liability. Indeed, the natural implication of saying that someone "shall be exempt * * * from tax" is that he was previously subject to the tax and is now relieved from paying it. In short, Article XIV would seem to have no application to residents of the United Kingdom who are not otherwise American taxpayers.

The result seems obvious. Since the beneficiaries neither received the capital gains nor owed the tax attributable to the transactions, there is no occasion to exempt them. And, since the trust itself is not a resident of the United Kingdom, it does not qualify for the exemption conferred by Article XIV of the Convention. Petitioner, however, does not recognize the impasse. In search of an exit, he imagines a middle road where trust and beneficiaries are con-

fused. The argument has several variants, but they all founder in the attempt to "pierce the fiduciary veil."

It is argued, for instance, that since the United Kingdom Convention does not expressly advert to trusts, it views the beneficiaries as the true recipients of the trust income, whether or not it is distributed to them. Thus, according to petitioner, the term "resident" in the Convention includes only natural persons and corporations; yet, the Convention certainly applies to the income of private trusts; therefore, its provisions must be read as ignoring the trust "fiction" and treating the income of a trust (whether or not retained) as the income of the individual beneficiaries.

We might answer that the same argument equally sustains the conclusion that the individual *legal* owner—the trustee—is the recipient of the trust income. But the fact is that the Convention recognizes the trust itself as a separate taxable entity. "Resident" is nowhere restricted to natural persons and corporations. On the contrary, as already noted, Article II(1)(g) of the treaty excludes from the definition of "resident of the United Kingdom" *"any person * * * who is * * * resident in the United States for the purposes of United States tax,"* and the American tax law views a trust as a separate taxable "person."⁶

⁶ Article II(1)(g) itself plainly justifies reference to American tax law to determine who are "resident persons" for tax purposes. But any doubt is resolved by Article II(3) (Pet. App. A5) which permits the taxing government to interpret any undefined term—the word "person" not being defined in the treaty—in accordance with its own laws, "unless the context otherwise requires."

(Emphasis added.) Sec. 3797(a)(4), 1939 Code; Sec. 7701(a)(1), 1954 Code.⁷

Failing in this technical approach, petitioner makes a more direct assault on the text of the treaty. He boldly asserts that the exemption conferred by Article XIV does not merely lift the direct tax liability of the British beneficiaries (there being none in the premises), but relieves them of the *indirect* effects of the tax as well. The difficulties remain insurmountable.

In the first place, as already noted, the contention flies in the face of the text invoked, which only exempts the British resident "from United States tax," and does not purport to relieve from the ultimate economic burden of the tax. More fundamentally, the application of an economic burden test in determining exemptions would contradict the whole scheme of trust taxation in the United States, a result neither required nor suggested by the language of the Income Tax Convention. Indeed, even assuming the scope of the exemption is unclear in the text, Article II(3) of the treaty, as we have already noted (see note 6, *supra*), expressly permits the taxing government to resolve ambiguities in accordance with its own laws.

The general rejection of economic burden concepts in American tax law is well settled. The classic state-

⁷ The British also treat trusts as separate taxable entities, although, as might be expected, their treatment apparently differs in detail from ours. Harvard Law School, World Tax Series, *Taxation in the United Kingdom*, par. 5/3.4; see also, generally, Koch, *Double Taxation Relief on Trust Income*, 1958 British Tax Rev. 272.

ment of the principle was given twenty-five years ago by Mr. Justice Stone in *Biddle v. Commissioner*, 302 U.S. 573, 581. In a related context, the Court there rejected a claim by the stockholder of a British corporation who argued that he was entitled to a credit for the British tax "appropriate" to his dividends but paid by the corporation because the "economic burden" of the levy fell on him:

Our revenue laws give no recognition to that conception. Although the tax burden of the corporation is passed on to its stockholders with substantially the same results to them as under the British system, our statutes take no account of that fact in establishing the rights and obligations of taxpayers. * * * Nor have they treated as taxpayers those upon whom no legal duty to pay the tax is laid. Measured by these standards our statutes afford no scope for saying that the stockholder of a British corporation pays the tax which is laid upon and collected from the corporation, and no basis for a decision that § 131 extends to such a stockholder a credit for a tax paid by the corporation—a privilege not granted to stockholders in our own corporations. * * *

Cf. *Klein v. Board of Supervisors*, 282 U.S. 19, 24.*

* The intergovernmental immunity cases also emphasize the characteristic of our tax law in which the legal incidence of the tax is controlling. See, e.g., *Alabama v. King & Boozer*, 314 U.S. 1, 8-9; *Curry v. United States*, 314 U.S. 14, 18; *Helvering v. Gerhardt*, 304 U.S. 405, 417, 420-423; *Graves v. N.Y. ex. rel. O'Keefe*, 306 U.S. 466, 480-481, 484; *Oklahoma Tax Comm'n. v. Texas Co.*, 336 U.S. 342, 363-364; and compare *Kern-Limerick, Inc. v. Scurlock*, 347 U.S. 110, 122, where the legal inci-

Specifically, our tax laws reject the economic burden notion with respect to the taxation of trusts. We have already noted the independent identity of trusts for tax purposes. With a single exception not here relevant,⁹ they are taxed without regard to the citizenship, residence, or tax status, of the beneficial owners. See Secs. 161-164, 1939 Code; Secs. 641-668, 1954 Code.¹⁰ With particular reference to capital trans-

ference of the tax was found to fall directly upon the United States.

Theoretical economic distinctions between "direct" and "indirect" taxes are irrelevant in the present context. See, e.g., Rolph, *The Theory of Fiscal Economics*, p. 80, and Dalton, *Principles of Public Finance*, pp. 23-24, 36 *et seq.* The question here is one of law and not of economics. See *Home Savings Bank v. Des Moines*, 205 U.S. 503, 519.

⁹The exception relates to trust income "permanently set aside" for designated eleemosynary purposes. Sec. 162(a), 1939 Code; Sec. 642(c), 1954 Code.

¹⁰We are entirely consistent in our treatment of a trust as a taxable entity separate from its beneficiaries. Thus, if a United Kingdom trust, not having a permanent establishment in the United States, derives capital gains (or dividends, interest, royalties, rents or the like) from United States sources, and such gains are not distributable to the beneficiaries, but are to be added to the corpus, they would be exempt from United States tax under Article XIV, in spite of the fact that the beneficiaries are not residents of the United Kingdom and the further fact that, if such capital gains were included in the distributive share of the beneficiaries, they would clearly not be exempt under Article XIV. See, e.g., Regulations Secs. 507.2(a), (c), (d)(4); 507.3(a)(1), (a)(4); 507.4(a), (c); 507.5(a), (c); 507.8 (compare Sec. 507.10); 507.103(e); 507.104(b)(4); 507.108(a)(1)(i), (c)(1), 26 C.F.R. 507, *et seq.* See also Rev. Rul. 56-30, 1956-1 Cum. Bull. 646, where an American beneficiary of an Australian trust deriving income from sources within the United States was held exempt from federal income tax on that portion of the income withheld by the trustee and added to corpus. It should be mentioned that Section 7 of the Revenue Act of 1962, P.L. 87-834, 76 Stat. 960, adds

actions, the rule is clear. As long ago as *Anderson v. Wilson*, 289 U.S. 20, 26-27, the Court rejected an economic burden argument offered in support of the beneficiary's claim for a personal deduction on account of a capital loss incurred by the trust:

We hold that the trust, and not the taxpayer, has suffered the loss * * *, and it follows that where loss has not been suffered, there is none to be allowed. * * * In so ruling we do not forget that the trust is an abstraction, and that the economic pinch is felt by men of flesh and blood. Even so, the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return under the hand of the fiduciary and claiming and receiving its own appropriate deductions. * * * The argument will not hold that what was lost to this taxpayer was not the capital of the trust, but rather his own capital, withdrawn from his possession, but held for his account by the executors as custodians or bailiffs. His capital was in the proceeds, to the extent that they were distributed, and never in the land. * * *

The rule is the same with respect to capital *gains* retained by the trust and added to corpus. They are taxed to the trust, without noticing the beneficiaries. Secs. 161(a) and 162(b), 1939 Code; Sec. 643(a), 1954 Code. And that remains true even when, as here, the

several new provisions to the 1954 Code to foreclose some of the tax avoidance opportunities theretofore available through the creation by American taxpayers of foreign trusts accumulating income abroad. These new provisions recognize the validity of the Treasury's position but change the law for the future.

beneficiaries themselves are exempt as nonresident aliens. See, *e.g.*, G.C.M. 10423, XI-2 Cum. Bull. 123 (1932); O.D. 743, 3 Cum. Bull. 203 (1920).

The language of the treaty gives every indication that this postulate of our tax laws was to continue undisturbed. Certainly nothing in the use of the term "exempt" suggests the application of an economic burden test. In our revenue laws that word, as applied to a juridical person,¹¹ intends relief for the potential taxpayer alone, no one else. See, *e.g.*, Secs. 101 and 165, 1939 Code; Secs. 501(a) and 521(a), 1954 Code. There is no pretext for expanding its meaning in the Income Tax Convention. On the contrary, every effort should be made to accommodate the treaty and our domestic law. *United States v. Lee Yen Tai*, 185 U.S. 213, 221-222; *Whitney v. Robertson*, 124 U.S. 190, 194; *Chew Heong v. United States*, 112 U.S. 536, 550.

We conclude that the text is clear. Permissible reference to our domestic law erases every possible doubt. But, even if we overstate the case, petitioner's reading of Article XIV must be rejected under the rule that "those who seek an exemption from a tax must rest it on more than a doubt or ambiguity." *United States v. Stewart*, 311 U.S. 60, 71.

¹¹ More often, especially under the 1939 Code, the term applies to a particular category of income, with more emphasis on the source than the identity of the recipient. See, *e.g.*, Secs. 22(b), 115(b) and 212(b), 1939 Code; cf. Sec. 894, 1954 Code. These uses are not properly comparable. Yet, even there, there is no implication that exemptions look beyond the potential taxpayer.

B. THE HISTORY OF THE TREATY SUGGESTS A NARROW READING OF
ARTICLE XIV

Given the plain words of Article XIV, there is scant excuse to look further. Yet, since petitioner relies entirely on external evidence, we follow him in that quest, deferring to the rule that treaties are "to be read in the light of the conditions and circumstances existing at the time they were entered into, with a view to effecting the objects and purposes of the States thereby contracting." *Rocca v. Thompson*, 223 U.S. 317, 331-332. See also, *Choctaw Nation v. United States*, 318 U.S. 423, 431; *Factor v. Laubheimer*, 290 U.S. 276, 294-295; *Cook v. United States*, 288 U.S. 102, 112; *Nielsen v. Johnson*, 279 U.S. 47, 52.¹²

The fact is, however, that the history of the Convention¹³ and the context in which it was adopted

¹² A comprehensive survey of the decisions of this Court dealing with the interpretation of treaties is given in 2 Hyde, *International Law Chiefly as Interpreted and Applied by the United States* (2d ed.), pp. 1478-1485; see also, Lauterpacht, *Restrictive Interpretation and the Principle of Effectiveness in the Interpretation of Treaties*, XXVI British Year Book of International Law (1949), pp. 48, 53, 67; American Law Institute, *Restatement of the Foreign Relations Law of the United States* (Proposed Official Draft, 1962), c. 4, pp. 536, *et seq.*; Harvard Research in International Law: Law of Treaties, Supplement to 29 Amer. Journal of Int. Law., pp. 937, *et seq.*; McNair, *The Law of Treaties* (1961), pp. 364, *et seq.*; Lidstone, *Liberal Construction of Tar Treaties*, 47 Cornell L.Q. 529, 544-546.

¹³ Most of the documents bearing upon the legislative histories of our double taxation treaties have been compiled by the Staff of the Joint Committee on Internal Revenue Taxation, U.S. Congress, in a four volume set entitled "Legislative History of United States Tax Conventions." That compilation is cited in this brief as "Leg. Hist." An additional volume entitled "A Topical Comparison of United States Income Tax Conventions"

merely confirm our reading of Article XIV. Far from justifying a broad construction, the external evidence shows an extreme reluctance to continue the prevailing exemption for the capital gains of non-resident aliens. There is certainly no indication that the Convention was intended to affect the taxability of an American trust on its own retained capital gains.

The United Kingdom Convention was adopted against a background of controversy over the taxation of nonresident aliens. Since the Revenue Act of 1936, 49 Stat. 1648, their capital gains had been exempted if they were "not engaged in trade or business within the United States." Sec. 211, 1939 Code, as amended by the Revenue Act of 1942, 56 Stat. 798, § 160.¹⁴ By 1945, there was a growing feeling

has also been prepared by the Staff. A comparison of the various treaty provisions relating to exemption of capital gains will be found at pages 8a through 8e, Row 1, of the latter volume.

The history of the British treaty is set forth in detail at 2 Leg. Hist. 2566-2567. Briefly, the treaty was signed at Washington on April 16, 1945, and was transmitted to the Senate by the President on April 24, 1945. The Committee on Foreign Relations held hearings in May and June, 1945, and submitted its report on July 3, 1945. The Senate recommitted the treaty to the Committee on February 6, 1946, and farther hearings were held in April, 1946. The treaty was again reported to the Senate on May 10, 1946, and the Senate gave its advice and consent on June 1, 1946. It was proclaimed by the President on July 30, 1946, and entered into force as of July 25, 1946, the date of exchange of instruments of ratification. See also, 1 Leg. Hist., table facing p. 6.

¹⁴ The explanation given for exemption of capital gains of nonresident aliens was that it had "been found administratively impossible effectually to collect this latter tax." S. Rep. No. 2156, 74th Cong., 2d Sess., p. 21 (1936) (1939-1 Cum. Bull.

that the exemption was too broad. In 1950, the tax law was amended to subject nonresident aliens *temporarily* in the country to capital gains tax. Revenue Act of 1950, 64 Stat. 906, § 213. Accordingly, it is not surprising that the Convention, submitted in a period of transition toward a stiffer law, met serious opposition insofar as it proposed to exempt from the capital gains tax all British citizens and residents who had no "*permanent establishment*" in the United States. Art. II(2), qualifying Art. XIV. See also, Art. II(1)(1), defining "*permanent establishment*"

A substantial part of the hearings on the Convention was devoted to consideration of the effect which Article XIV might have upon existing law relating to the taxation of capital gains of nonresident aliens.¹⁵ Concern with this problem was emphasized by the Senate Committee on Foreign Relations. Its Report of July 3, 1945, recites (S. Exec. Rep. No. 6, 79th Cong., 1st Sess., p. 2, 2 Leg. Hist. 2652) :

(Part 2) 678, 691-692) : H. Rep. No. 2475, 74th Cong., 2d Sess., p. 9 (1936) (1939-1 Cum. Bull. (Part 2) 667, 673). See also H. Rep. No. 1546, 75th Cong., 1st Sess., pp. 30-31 (1937) (1939-1 Cum. Bull. (Part 2) 704, 725-726) ; S. Rep. No. 1242, 75th Cong., 1st Sess., pp. 32-33 (1937) (1939-1 Cum. Bull. (Part 2) 703, 725-726). The Revenue Act of 1942, c. 619, 56 Stat. 798, Section 160, eliminated the words "or having an office or place of business within the United States" as a factor in the taxing of nonresident aliens.

¹⁵ 1 Hearing Before a Subcommittee of the Committee on Foreign Relations, on Conventions With Great Britain and Northern Ireland Respecting Income and Estate Taxes, S. Execs. D and E, 79th Cong., 1st Sess., pp. 25-27 (memorandum), p. 45 (Brief of National Foreign Trade Council), pp. 53-54 (Code), pp. 61-62 (King), pp. 66-68 (Carroll), pp. 73-75, 76, 79 (Stam) ; 2 Leg. Hist. 2591-2593, 2611, 2619-2620, 2627-2628, 2632-2634, 2639-2641, 2642, 2645.

Incident to your subcommittee's consideration of the proposed convention, four certain questions have attracted its special attention, namely:

* * * * *

(2) The relation of the provisions of the convention to our domestic principles of taxation of capital gains (primarily stocks, securities, and commodities) as applied to the alien resident in the United States and the nonresident alien who is engaged in trade or business in the United States;

Although the Committee reported it favorably on July 3, 1945 (Report, *supra*, p. 1, 2^d Leg. Hist. 2651), action on the Convention was delayed (91 Cong. Record, p. 7448, 2 Leg. Hist. 2669) and, on February 6, 1946, it was recommitted to the Committee on Foreign Relations¹⁶ for further hearing (92 Cong. Record, pp. 946-947, 2 Leg. Hist. 2673). One of the reasons for the recommitment, as shown by the later Hearings¹⁶ and by the second Report of the Senate Committee on Foreign Relations,¹⁷ was continued concern over the possible effects of Article XIV.

The British convention was ultimately ratified, but it was the last of the agreements to confer an effective capital gains exemption on nonresident aliens. Similar provisions originally included in the Conventions

¹⁶ 2 Hearing Before a Subcommittee of the Committee on Foreign Relations, on Conventions with Great Britain and Northern Ireland Respecting Income and Estate Taxes, S. Exec. D and E., 79th Cong., 2d Sess. (Part 2), pp. 116-120 (King), 2 Leg. Hist. 2712-2716.

¹⁷ S. Exec. Rep. No. 4, 79th Cong., 2d Sess., pp. 1, 2, 3-8; 2 Leg. Hist. 2721, 2722, 2723-2728.

signed with Denmark (62 Stat. 1730; 1 Leg. Hist. 711, 747—Art. XIH) and the Netherlands (62 Stat. 1757; 2 Leg. Hist. 1921, 1927—Art. XI), were unfavorably reported,¹⁸ and the treaties were ratified subject to reservations rejecting the offensive Articles.¹⁹ The Convention with Ireland; transmitted to the Senate in 1950²⁰ met the same fate,²¹ despite an appeal to the

¹⁸The report on the Danish treaty stated (S. Exec. Rep. No. 10, 80th Cong., 2d Sess., p. 2, 1 Leg. Hist. 698):

"The committee, however, in its consideration of the convention, has been aware of the pendency in Congress of the question of amending existing provisions of the Internal Revenue Code relating to the taxation of capital gains derived by nonresident aliens or by foreign corporations from sources within the United States, and of the effect thereon of provisions of existing tax conventions containing articles relating to capital gains. The proposed convention, in article XII, would exempt from United States income tax the capital gains of nonresident aliens who are residents of Denmark and Danish corporations, if such alien or corporation is not engaged in trade or business within the United States.

"The committee feels that it is untimely to freeze by tax conventions the provisions of existing law in that respect pending further legislative consideration of the question."

The report on the Netherlands treaty was to the same effect. S. Exec. Rep. No. 11, 80th Cong., 2d Sess., p. 2, 2 Leg. Hist. 1908.

¹⁹ Denmark—94 Cong. Record, p. 8622, 1 Leg. Hist. 703-704; Netherlands—94 Cong. Record, p. 8625, 2 Leg. Hist. 4914.

²⁰ Message from the President, S. Exec. F, 81st Cong., 2d Sess., p. 1, 2 Leg. Hist. 1584A.

²¹ S. Exec. Rep. No. 1, 82d Cong., 1st Sess., pp. 19-20, 1 Leg. Hist. 603-604. The report said, in part (p. 20, 1 Leg. Hist. 604):

"Because of the strong objections which have been raised previously in the Congress to the exemption of nonresident aliens from tax on their capital gains from transactions entered into in the United States, the committee recommends that article XIV of the convention with Ireland relating to income taxes be eliminated and proposes a reservation to that effect."

"intimate relation" between the tax laws of Ireland and Great Britain.²²

The hostile climate strongly suggests that Article XIV of the British Convention would never have won ratification had it been understood as conferring the indirect exemption urged here. Indeed, the provision was accepted, albeit reluctantly, on assurances²³ that it

²² Message from the President, *supra*, fn. , pp. 3, 5; 2 Leg. Hist. 1584-C, 1584-E.

²³ Message from the President, S. Exec. D. 79th Cong., 1st Sess., p. 1, 2 Leg. Hist. 2573. The President's Message was accompanied by a report of the Secretary of State advising that "In matters of principle and substance, most of the provisions of the convention relating to taxes on income are consistent, if not identical, with provisions in one or another of the existing income-tax conventions between the United States of America and certain foreign countries, namely," Sweden, Canada and France. S. Exec. D. *supra*, p. 2, 2 Leg. Hist. 2574. A more detailed explanation of the significant provisions of the Convention was then given, "particularly with a view to indicating the extent to which the convention may modify the existing revenue laws of the United States." *Id.*, p. 4, p. 2576. No mention was there made of Article XIV as one which "may modify the existing revenue laws." As the subsequent history shows, the Senate was in no mood to extend exemption of capital gains further than had been done in the previous conventions.

The Report of the Senate Committee on Foreign Relations (S. Exec. Rep. No. 6, 79th Cong., 1st Sess., p. 4, 2 Leg. Hist. 2654), indicates that those assurances were credited:

"* * * As above indicated, there may be certain cases falling in between the test of being engaged in trade or business and having a permanent establishment where the convention is more liberal than existing law, but there are other compensating factors and no such technical conflict exists where the test of taxation is residence. Moreover, the same provisions found in the British convention are now in effect under the conventions with Canada, Sweden, and France." (Emphasis added.)

See also the references to Article XIV in the Technical Memorandum of the Treasury Department on the Convention; S. Exec. Rep. No. 6, *supra*, pp. 5, 6, 12; 2 Leg. Hist. 2655, 2656, 2662.

accorded British citizens and residents no greater relief with respect to capital gains than had already been accorded nonresident aliens in the recent tax treaties with Sweden, France and Canada.²⁴ And the Regulations promulgated under those Conventions expressly affirmed the continued taxability of undistributed trust gains, unaffected by the exemption granted the beneficiaries as nonresident aliens with respect to their own capital gains.²⁵

Against this background, petitioner's arguments are not persuasive. Certainly nothing can be read into the absence of an explicit "savings clause." For, while the Swedish, French and Canadian Conventions contain such a clause,²⁶ we have just seen that the British treaty meant to go no further in exempting capital gains. The answer is, of course, that Article II(1)

²⁴The respective dates are (Tables at 1 Leg. Hist. 6) :

Country	Signed	Proclaimed by	Capital Gains Article
		President	
Sweden	3/23/39	12/12/39	IX
France	7/25/39	1/ 5/45	11
Canada	3/ 4/42	6/17/42	VIII
United Kingdom	4/16/45	7/30/46	XIV

The delay in the adoption of the French treaty was caused by World War II. S. Exec. Rep. No. 4, 78th Cong., 2d Sess., p. 1, 1 Leg. Hist. 881.

²⁵The relevant sections of the Regulations are: Canada, Section 519.11, 26 C.F.R. 519.11; France, Section 514.7, 26 C.F.R. 514.7. The Swedish Regulations, which were the first in the series to be issued, do not contain a corresponding provision. See, however, Section 520.102 of the Swedish Regulations, 26 C.F.R. 520.102.

²⁶Sweden, Art. XIV(a), 2 Leg. Hist. 2365; France, Art. 14A, 1 Leg. Hist. 915-916; Canada, Art. XVII, 1 Leg. Hist. 481. See Staff of the Joint Committee on Internal Revenue Taxation, U.S. Congress, A Topical Comparison of United States Income Tax Conventions, pp. 2a-2e, Row 4.

(g) of the United Kingdom Convention, which excludes from the scope of Article XIV American citizens, American corporations, and all persons deemed "resident in the United States for the purposes of United States tax," accomplishes the same end. Rev. Rul. 59-56, 1959-1 Cum. Bull. 737, 738, 741. See also, S. Exec. Rep. No. 6, 79th Cong., 1st Sess., pp. 4, 12, 2 Leg. Hist. 2654, 2662; Sen. Exec. Rep. No. 4, 79th Cong., 2d Sess., pp. 11, 19, 2 Leg. Hist. 2731, 2739.

Nor is there substance to petitioner's "reciprocity" and "equality" arguments. The plain fact is that the treaty was never intended to achieve full equality of treatment between citizens and residents of the two governments. One object of Article XIV was to eliminate a possible area of double taxation, with respect to those capital gains which the British then,²⁷ or later,²⁸ might tax. But, to a larger extent perhaps, the provision was simply a concession made by the American government in return for other concessions made by the British, particularly in the area of fiscal information. See Message from the President, S.

²⁷ For illustrations of taxable capital gains under the former British law, see Brudno and Hollman, *The Taxation of Capital Gains in the United States and the United Kingdom*, 1958 British Tax Rev. 26, 134. That the present transactions would not have been taxed in the United Kingdom hardly proves that the Article, which applies to *all* capital gains, was not addressed to the problem of double taxation.

²⁸ The fact is that British law as to the taxation of capital gains was in a state of flux. See the 1958 Final Report of the Royal Commission on the Taxation of Profits and Income, Cmd. 9474, pp. 25 *et seq.*, 365 *et seq.*, 425 *et seq.* This culminated in adoption of provisions in 1962 expressly taxing capital gains. Finance Act, 1962, c. II, Secs. 10-16, 10 and 11 Eliz. 2, c. 44, Law Reports, Statutes, 1962, part 3, pp. 695, 707 *et seq.*

Exec. D., 79th Cong., 1st Sess., p. 5, 2 Leg. Hist. 2577.²⁹ Only in this sense is Article XIV "reciprocal."³⁰

In sum, there is in all the history of the negotiation and ratification of the British Convention not the slightest hint that it was intended to reach further than the text itself suggests. On the contrary, the external evidence confirms the expressed purpose of the treaty to exclude from its scope all "persons" whom either sovereign viewed as a taxable resident. Plainly, the Convention was addressed to *international* problems; it was not meant to disturb the structure of American tax law as it affects American income of resident American taxpayers. The true goal of the Convention, as the Proclamation which precedes it announces (Pet. App. A1), was "the avoidance of double taxation and the prevention of fiscal evasion," problems altogether foreign to this case. The conclusion must be that the present trust is beyond the treaty's jurisdiction.

C. THE TREASURY REGULATIONS PROMULGATED UNDER THE CONVENTION REJECT PETITIONER'S CLAIM OF EXEMPTION

Immediately after the treaty was ratified, both countries promulgated regulations to carry it into ef-

²⁹ See also, the testimony of Special Deputy Commissioner King relating the American concession in Article XIV directly to the British concession in Article XX. 1 Hearing on Conventions, etc., *supra*, Execs. D and E, 79th Cong., 1st Sess., pp. 56-58, 60, 61-62; 2 Leg. Hist. 2622-2624, 2626, 2627-2628.

³⁰ Our willingness to agree to Article XIV is partly attributable to the difficulties of collecting the tax due by non-resident aliens. See 1 Hearing, *supra*, p. 26, 2 Leg. Hist. 2592. Needless to say, the same problems are not encountered in connection with a domestic trust.

fect.³¹ The American regulations, which of course govern as to taxes imposed by the United States, confirm our reading of Article XIV.

Thus, Section 507.103(b) of the Treasury Regulations (App., *infra*, p. 29) interprets the treaty as exempting capital gains resulting from sales or exchanges "by" a British resident—not gains realized by someone else³² *for the eventual benefit* of a British resident. See also, Section 507.112 (App., *infra*, pp.

³¹ Our Treasury Regulations were issued originally as T.D. 5532, 1946-2 Cum. Bull. 73 (withholding regulations), and T.D. 5569, 1947-2 Cum. Bull. 100 (general regulations). They appear as Title 26, Part 507, Code of Federal Regulations, p. 106 *et seq.* The British Double Taxation Relief (Taxes on Income) (U.S.A.) Regulations, 1946, appear at Vol. X Statutory Rules and Orders and Statutory Instruments, Revised to December 31, 1948, pp. 332-333; see also Double Taxation Relief (Taxes on Income) (General) Regulations, 1946, *id.*, pp. 328-331. In addition, the British issued several relevant "circulars". Ehrenzweig and Koch, *Income Tax Treaties*, pp. 288-296.

³² Section 507.104 of the Regulations, defining "resident of the United Kingdom," states that it includes a "fiduciary." Therefore, a United Kingdom trust deriving capital gains from United States sources, and not distributing them to the beneficiaries, would be exempt from tax thereon under Article XIV even though the beneficiaries were residents of the United States. See fn. 10, *supra*. If the petitioner's position in this case were adopted, the result would be that capital gains of a British trust with American beneficiaries would be deprived of the exemption. This illustrates, as is frequently the case when a tax provision is sought to be given a "liberal" interpretation, that what is liberal as to one party may be illiberal as to others. Cf. *Helvering v. Hutchings*, 312 U.S. 393, 397.

30-31).³³ Any remaining doubt is dispelled by Section 507.108(c) of the Regulations (App., *infra*, p. 30):

(c) *Beneficiaries of an estate or trust.* (1)

A nonresident alien who is a resident of the United Kingdom and who is a beneficiary of a domestic estate or trust, shall be entitled to the exemption * * * provided in Articles * * * XIV of the convention with respect to * * * capital gains *to the extent such items or items are included in his distributive share of income* of such estate or trust if he * * * is not engaged in trade or business in the United States through a permanent establishment. * * * [Emphasis added.]³⁴

Embodying as they do the contemporaneous construction of those charged with the administration of the treaty, the Treasury Regulations are of course entitled to great weight. *Kolovrat v. Oregon*, 366 U.S. 187, 194; *Pigeon River Co. v. Cox Co.*, 291 U.S. 138, 160-161; *Factor v. Laubenheimer*, 290 U.S. 276, 294-295; *Nielsen v. Johnson*, 279 U.S. 47, 52; American Law Institute, *Restatement of the Foreign Relations Law of the United States* (Proposed Official Draft 1962), Sec. 155, p. 558 *et seq.*³⁵ But, here,

³³ Petitioner recognizes the obvious implications of the word "by" (Pet. Br. 41).

³⁴ We have omitted from this quotation language which is relevant to the other exemptions or reductions in tax generally covered by the provision. We agree with the petitioner (Br. 40) that the words "if he is taxable in the United Kingdom on such income" do not apply to the capital gains exemption of Article XIV. See also, Section 507.10 (App., *infra*, p. 28).

³⁵ Petitioner's suggestion (Br. 42) that the Regulations should be viewed with "skepticism" because they were issued without authority under the treaty is refuted by the practical action of the parties. Furthermore, Section 62 of the 1939 Code, under which they were issued, is sufficient authority. See Regulations, Section 507.102.

there are additional reasons for according them special significance.

Every indication is that the Regulations just cited were approved by the British Government before promulgation. Indeed, during the course of the hearings on the proposed double taxation treaty with France (S. Exec. A., 80th Cong., 1st Sess.), Special Deputy Commissioner Eldon P. King testified (p. 24, 1 Leg. Hist. 962):

Now we come to the regulation. It depends somewhat on the nature of it and the importance of it. *If it is something we think the other country should see, we show them the regulation. We did that with Canada, we did it with England. We had joint meetings and went over the regulations together, and all agreed. They do the same with us. If they are getting ready to is[s]ue something they think we will have an interest in, they send it to us, so you might say it is joint, except in the case of a pro forma matter that the other country could not possibly have an interest in. [Emphasis added.]*

That there was advance agreement is apparent, also, from a comparison of the American and British regulations, issued almost simultaneously. Their consistency is not accidental.

In any event, the fact is that the Regulations have survived to this day without objection. In connection with the Second Supplementary Protocol of May 25, 1954 (6 U.S.T. 37; 2 Leg. Hist. 2819), Which extended the application of the treaty to certain British territories, the United Kingdom had ample opportu-

nity to voice dissatisfaction with our interpretation. See also Agreement between the United States and the United Kingdom (9 U.S.T. 1459; 2 Leg. Hist. 2951). Likewise, our Own Congress has not lacked occasion to require changes in the Regulations. Yet, no complaints have been heard: no change has been suggested. The reason must be that the Regulations correctly interpret the treaty.

CONCLUSION

For the reasons stated, the decision of the court of appeals should be affirmed.

Respectfully submitted,

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MARCH, 1963.

APPENDIX

Treasury Regulations on Tax Convention with United Kingdom (26 Code of Federal Regulations):

PART 507—UNITED KINGDOM

SUBPART—WITHHOLDING OF TAX

* * * *

Sec. 507.10 *Beneficiaries of a domestic estate or trust.*

A nonresident alien who is a resident of the United Kingdom and who is a beneficiary of a domestic estate or trust, shall be entitled to the exemption, or reduction in the rate of tax, as the case may be, provided in Articles VI, VII, VIII, and IX of the convention with respect to dividends, interest, royalties, natural resource royalties, and rentals from real property to the extent such item or items are included in his distributive share of income of such estate or trust. In such case such beneficiary must, in order to be entitled to the exemption or reduction in the rate of tax, execute Form 1001A-UK and file such form with the fiduciary of such estate or trust in the United States.

* * * *

SUBPART—GENERAL INCOME TAX

* * * *

Sec. 507.103. *Scope of the convention.*

(a) The primary purposes of the convention, to be accomplished on a reciprocal basis, are to avoid double taxation upon major items of income derived from sources in one country by persons resident in the other country, and to

exchange fiscal information complementary to other provisions of the convention, including those relating to avoidance of double taxation.

(b) The specific classes of income from sources within the United States exempt under the convention from United States tax for taxable years beginning on or after January 1, 1945, are:

(7) Gains from the sale or exchange of capital assets by a nonresident alien who is a resident of the United Kingdom or by a foreign corporation managed and controlled in the United Kingdom, if such alien or corporation has no permanent establishment in the United States (Article XIV):

(c) The convention does not affect the liability to United States income taxation of subjects of the United Kingdom who are residents of the United States except that such individuals are entitled to the benefits of Article X (relating to United Kingdom Government salaries and the like), of Article XIII(1) (relating to credit for United Kingdom income tax), and of Article XXI (relating to equality of taxation). Except as provided in Article X with respect to a citizen of the United States who is also a British subject and in Article XIII relating to the credit for income tax, the convention does not affect taxation by the United States of a citizen of the United States or of a domestic corporation, even though such citizen is resident in the United Kingdom and such corporation is managed and controlled in the United Kingdom.

Sec. 507.108. *Exemption from, or reduction in rate of, United States tax in the case of dividends, interest, royalties, natural resource royalties, and real property rentals.*

(c) *Beneficiaries of an estate or trust.*

(1) A nonresident alien who is a resident of the United Kingdom and who is a beneficiary of a domestic estate or trust, shall be entitled to the exemption * * * provided in Articles * * * XIV of the convention with respect to * * * capital gains to the extent such item or items are included in his distributive share of income of such estate or trust if he * * * is not engaged in trade or business in the United States through a permanent establishment. In such case such beneficiary must, in order to be entitled to the exemption or reduction in the rate of tax, execute Form 1001-UK or Form 1001A-UK (modified to show dividends where applicable) and file such form with the fiduciary of such estate or trust in the United States.

(2) In any case in which dividends, interest, royalties, rents or the like are derived from United States sources by a United Kingdom estate or trust any beneficiary of such estate or trust who is not a resident of the United Kingdom is not entitled to any exemption under the convention with respect to such income included in his distributive share of the income of the estate or trust.

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Sec. 507.112 *Capital Gains.*

Under Article XIV of the convention, when read in association with Article II(2) of the convention, gains from the sale or exchange of capital assets by a nonresident alien individual who is a resident of the United Kingdom or by a foreign corporation managed and controlled in the United Kingdom are, for taxable years beginning on or after January 1, 1945, exempt from Federal income tax unless such alien or corporation has a permanent establishment in the United States. As to what constitutes capital assets, see section 117, Internal Revenue Code. As to what constitutes a perma-

ment establishment see § 507.104. If A, a non-resident alien individual who is a resident of the United Kingdom, performs personal services within the United States during the calendar year 1946 for a domestic employer, he is engaged in trade or business within the United States in such taxable year. Section 211(b), Internal Revenue Code. He carries on in that year no other business activity within the United States other than certain securities transactions upon a domestic stock exchange and maintained no office or other fixed place of business within the United States at any time during such year. A is not subject to Federal income tax upon his capital gains, if any, realized from his securities transactions. Likewise, a foreign corporation managed and controlled in the United Kingdom selling its products manufactured in the United Kingdom through a resident commission agent or broker in the United States and having certain securities transactions within the United States as its only other business activity therein is exempt from United States tax upon those capital gains, if any, arising from the securities transactions within the United States.